Testimony of

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On behalf of the

Independent Community Bankers of America

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Hearing on

"Implementation of The Community Reinvestment Act"

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Mr. Chairman and Ranking Member Bachus, I am Cynthia Blankenship, Vice-chairman and Chief Operating Officer of Bank of the West in Irving Texas. I am also Chairman-elect of the Independent Community Bankers of America.[1] I am pleased to have this opportunity to present the views of the nation's community bankers on the implementation of the Community Reinvestment Act.

ICBA represents 5,000 community banks throughout the country. Bank of the West is part of a two-bank holding company with assets of $250 million. We have eight locations in the Dallas/Fort Worth metroplex. We serve the small business community with a focus on SBA lending and real estate. The other institution in the holding company is the Bank of Vernon with assets of $30 million located in Vernon, Texas which is an agricultural community.

My testimony today will describe community banks' commitment to their communities and policies that enhance our ability to carry out that commitment. It then reviews the history of the implementation of the Community Reinvestment Act, with a particular emphasis on exam procedures that are tiered to recognize the differences between banks of different sizes. Finally, we strongly urge Congress to extend CRA to the credit union industry. This would recognize the vast differences between the credit union industry of today and that industry as it existed in 1977, when CRA became law.

Community Banks Invest in Their Communities

The Community Reinvestment Act requires that federal bank regulators evaluate how each FDIC-insured institution affirmatively meets "the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution," and take that record into account when evaluating an application for a deposit facility by the institution.

Community banks are locally owned and operated institutions that are integral parts of their communities and engage in community reinvestment and community development on a daily basis. Community banks generally serve only their local communities with deposit, lending and other banking services.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

Local community bankers frequently play a key role in many civic activities, such as serving on the development corporation board, hospital board, chamber of commerce or school board. In part, this is good business practice for community bankers. But a primary goal is to ensure their local communities are vibrant and thriving. The health of the bank is closely interwoven with the ongoing economic vitality of the local community and its residents

Access to credit and equity capital is an essential ingredient for creating and retaining jobs, developing affordable housing, revitalizing neighborhoods, and enhancing the economies of cities and rural communities. ICBA strongly supports community reinvestment and community development as a means of addressing these needs.

Over the last 20 years, banks have been consolidating into large multi-state operations. One of the collateral effects is that local community groups no longer have access to a local decision-maker in these banks who is integrally involved with the community. In contrast, the local community banker understands community needs and can make quick decisions regarding funding for housing, job-creating small businesses and other local economic needs. Such is not the case when a funding request must go through a branch of a multi-state bank and is then forwarded to an office many miles away where the request can become mired in a bureaucracy.

ICBA Supports Incentives for Community Investments

ICBA believes public policy can build on community banks' commitment to their communities by providing incentives and by removing unnecessary regulatory costs that detract from smaller banks' ability to serve their communities.

Fortunately, some of these incentives are already in place, and ICBA encourages policymakers to take steps to expand on these programs. For example, my bank places special emphasis on small businesses. One of our primary goals is to provide them with long term capital by originating and servicing small business loans through the loan guarantee programs of the Small Business Administration.

One important step would be for the Senate to enhance SBA programs by adopting H.R. 1332 which passed the House last year. The legislation would reduce SBA fees and permit a low-documentation loan program for seasoned lenders. The provisions are also included in Rep. Nydia Velazquez's Communities First Act (H.R. 1869). Streamlining and simplifying SBA loans and taking steps to encourage additional lenders to participate are key to promoting economic development in our communities.

Community banks also have provided homebuyers with common-sense mortgages that enabled them to both become and remain homeowners. The Federal Home Loan Banks and the housing GSEs, Fannie Mae and Freddie Mac, have been valuable partners for community banks in these efforts.

Last November, ICBA working with our partners, sponsored National Community Mortgage Week. Under that program, ICBA bankers held open-houses in nearly 1,000 locations. Community bankers reviewed mortgage documents and discussed financing options with consumers. As well-capitalized, stable, common sense lenders, community bankers were available to help clear up homeowners' confusion homeowners and help them refinance their existing mortgage.

Congress could also enhance community banks' ability to serve our customers by enacting regulatory relief provisions included in Rep. Velazquez's Communities First Act (H.R. 1869). The Act includes reductions in the paperwork burden that falls disproportionately on community banks. These tasks take time and staff resources that could be better used serving our customers.

ICBA is pleased that the House-passed GSE regulatory reform bill (H.R. 1427) includes important enhancements to the FHLBanks' Community Financial Institution program. That program, enacted as part of the Gramm-Leach-Bliley Act, permits the FHLBanks to assist CFIs' lending to agriculture and small businesses, providing another incentive for community reinvestment. The House bill permits more community banks to qualify for the program by increasing the eligibility threshold to $1 billion in assets. It also directs the new regulator to more closely oversee the FHLBanks' implementation of this program.

Finally, the House has passed the Depository Institution Community Development Investments Enhancement Act (H.R. 1066). That bill revises the statutory language for permissible public welfare investments by banks which was enacted in the Financial Services Regulatory Relief Act of 2006. The revisions permit banks to make investments in:

- designated disaster areas that were not low- or moderate-income (LMI) prior to the disaster;
- underserved or distressed rural communities that do not meet the LMI definition; and
- mixed-income affordable housing in areas targeted for revitalization in conjunction with government-sponsored housing initiatives.

The bill also permits banks to use New Markets tax credits in high poverty census tracts where area median incomes do not meet the LMI definition. ICBA and other groups have urged the Senate to pass this legislation. This legislation will help banks to continue making investments that benefit the public welfare and contribute to the overall health and vitality of their local communities.

Successful Reduction in CRA Paperwork

Over the past 15 years, the Federal banking agencies have successfully reduced the unnecessary and unproductive paperwork burden imposed on community banks under the Community Reinvestment Act regulations and examination procedures. As a result, community bankers can re-focus their efforts to actually investing in their communities, rather than documenting their efforts. Instead of allocating resources to the process, community bankers can make loans and investments that benefit their communities.

Before the agencies began this effort, ICBA released a study[2] conducted by Grant Thornton which reported that CRA compliance was the single most expensive regulatory burden placed on community banks. In that 1992 study, Grant Thornton studied the amount of time a representative sample of community banks actually spent preparing the paperwork that was the hallmark of CRA compliance at the time. Based on this data, Grant Thornton estimated that community banks spent 14.4 million hours on CRA compliance, double the number of hours they spent on the next most burdensome regulation, Truth in Lending. The annual dollar cost was an estimated $1 billion. One Wisconsin banker described the situation this way:

> In a community of less than 350 buildings, one bank and a 2.5 block business district, the absurdities of CRA become readily apparent. We are required to spend hundreds of non-productive hours building documentation to prove what is readily apparent from a zip code list of either deposits or loans: We get our deposits locally and we lend locally.[3]

Not only were the CRA examination procedures ill-suited to community bank operations, they actually put community banks at a disadvantage when compared with larger institutions. Large banks' branch networks generally avoid direct CRA examination. And, such banks can afford to hire staff dedicated to CRA compliance. In contrast, smaller banks often simply have existing employees take on these responsibilities.

This outcome contradicted the prediction by the primary author of the 1977 Act, Chairman William Proxmire (D-Wisc.), that CRA would not impose additional paperwork on banks. "We would all be happier to have minimal regulations; but on the basis of experience in those two States, the regulations would be very minimal, and would not require additional reporting."[4]

[2] *Regulatory Burden; The Cost to Community Banks.* A study prepared for the Independent Bankers Association of America by Grant Thornton.
[3] *Materials on the Regulatory Burden,* submitted by for the Independent Bankers Association of America to the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, June 23, 1992.
[4] Congressional Record S 8960 – June 6, 1977

ICBA is pleased to report that the streamlined examination procedures for smaller banks that the regulators adopted in 1995, and improved in 2007, helped move CRA compliance costs toward Chairman Proxmire's original intent.
The current tiered CRA examination system is less burdensome, more flexible, and recognizes the unique challenges of rural areas by expanding the definition of "community development" activities in underserved non-metropolitan middle-income markets.

These changes to the CRA examination procedures have not changed the statutory requirements imposed under the Act. Community banks are still required to invest in their communities – which they would do regardless of the Act. However, the paperwork requirements are substantially reduced. Performance, not production of paper, is the examiners' focus.

The agencies began the process of reforming CRA in 1993 when President Clinton directed them to review their CRA examination procedures with an eye to shifting their emphasis to performance rather than paperwork. At that time, CRA performance evaluations had degenerated into form over function, and many bankers and community groups were ready for a change. In a Herculean effort, the agencies, community groups and bankers – including the ICBA – played an active role to overhaul the CRA regulations and examination procedures.

ICBA urged the agencies to recognize the differences between community banks and their larger competitors and adopt a tiered system with streamlined examination procedures focused on lending performance for smaller banks.

In August 1993 ICBA proposed that community banks which meet certain criteria be granted a satisfactory rating. These criteria included:

- Makes the majority of its loans locally and has a good loan mix, including commercial, agricultural, real estate, and consumer.
- Has no legitimate, bona-fide, complaints from community members.
- Has a reasonable loan-to-deposit ratio based on peer group analysis and local economic conditions.
- Has no evidence of discriminatory practices.
- Has properly delineated its community.
- Has orally reported to examiners its ascertainment of community needs and community outreach.

In 1995, the federal banking agencies completely revised the CRA examination process. Instead of focusing on the process of compliance, the new rules focused on actual performance. The new rules established a test for smaller institutions – ones with less than $250 million in assets – designed to determine whether they were *actually complying.*

These criteria closely tracked our association's recommendations:

- A reasonable loan-to-deposit ratio.
- Percentage of the bank's lending activity in the bank's service area.
- Distribution of loans to borrowers of different income levels and business and farms of different sizes.
- Geographic distribution of loans within the bank's service area.
- Record of action taken, if warranted, in response to written complaints about the bank's CRA performance.

Bankers quickly concluded that the regulations had succeeded in their basic goal: emphasize performance over paperwork. Under these regulations, examiners look at a bank's *actual performance* – the loans and investments it makes in its community – and not documentation of the bank's *study* of community needs. The revisions streamlined and reduced the paperwork burdens associated with CRA and freed bankers to put their resources – both time and funding – where it counts: on actually performance that benefits their communities.

When the Federal banking agencies adopted these new rules in 1995, they committed to a comprehensive review after five years to make certain that the goal of reducing burden and focusing on performance instead of process were being met. The agencies began their review in 2000 and published an advance notice of proposed rulemaking in July 2001 asking for public comment.

By that time it was clear that the definition of "small bank" required an update. Over time, as banks merged and the idea of one bank stretching from coast-to-coast became a reality – the differences between large banks and small banks became more pronounced. A 2002 Grant Thornton study[5] found that examination costs placed an unfair burden on "large" community banks. According to a survey of community banks, the mean employee cost attributable to CRA (full and part-time employees) was 36.5 percent higher ($115,270 annually) at large community banks than at small community banks ($84,443 annually). In each of two case studies—one contrasting costs for a bank that grew from "small" to "large" bank status, and one contrasting costs for a "small" and "large" bank owned by the same holding company—CRA compliance costs were four or more times greater for large community banks than for small ones.

After reviewing the public comments, the federal banking agencies wrestled with how to adjust the successful tiered review process to update it and found themselves at an impasse. The Office of Thrift Supervision broke the logjam by publishing a final rule raising the size limit for small savings associations eligible for the streamlined exam from $250 million to $1 billion.

[5] *The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks.* Grant Thornton, September 16, 2002

In August 2004, the other agencies published a similar proposal, but added a community development test for mid-tier institutions between $250 million and $1 billion in assets. The community development test for mid-tier "intermediate small banks" was intended to meet the demands of community groups that banks demonstrate their commitment to community development while also alleviating some of the burdens and costs associated with the large bank exam assessment. In August of 2005, the FDIC, Federal Reserve, and Comptroller of the Currency adopted a joint final rule along these lines. The OTS revised its rule on March 22, 2007, conforming its rule to the other agencies' by including the community development test for thrifts with assets between $250 million and $1 billion in assets.

Credit Unions Should Not Be Exempt from CRA

While the banking agencies have made effective improvements to CRA examination procedures that apply to banks and thrifts, an important competitor for community banks – the credit union industry – remains completely exempt from CRA.

When Congress enacted CRA in 1977 the vast majority of credit unions served members of a single group with a limited product line. The credit union world has changed substantially since then, with Congress and the National Credit Union Administration expanding credit unions' product line and geographic reach:

- Credit unions have substantial leeway to offer business loans and aggressively skirt the statutory 12.25 percent cap;
- Many credit unions have converted to community charters, making their geographic footprint equivalent to their community bank competitors; and
- A large number of credit unions now serve so many disparate groups that virtually anyone with a pulse can become a credit union customer.
- There is an increasing number of large, full service, credit unions over $1 billion in assets.

As a result of these and other changes, the credit union industry has become a full and direct competitor with community banks. The Congressional Research Service has reported that through credit union service organizations, "credit unions may provide their members with panoply of sophisticated financial services and products that rivals the offerings of banks and thrifts." The CRS report notes that "over the past 30 years, most of the distinctions between credit unions and other depository institutions have been eliminated or reduced because of deregulation; consequently, the justification for the tax exemption for credit unions has been increasingly questioned."[6]

[6] Congressional Research Service. "Should Credit Unions be Taxed?" August 2005.

Today's credit unions have virtually no limit to their customer base; the "common bond" requirement has become meaningless. For example, NCUA gave the Los Angeles Financial Credit Union approval to serve: "Anyone who lives, worships, works in, or attends school in Los Angeles County." This encompasses a county of more than 10 million people and a geographic area larger than the states of Delaware and Rhode Island combined. Other examples abound.

We note that the state of Massachusetts already requires credit unions to comply with the state CRA statute. While Massachusetts has led the way in this area of competitive inequity between community banks and credit unions, we must also point out that credit unions in every state remain exempt from taxation.

In 2005, the Tax Foundation undertook an analysis of the credit unions' Federal Tax exemption.[7] The study calculated that the exemption is worth $2 billion annually. For the average credit union, this meant a return on assets ½ percentage points – 50 basis points – higher than the average bank. Only 6 basis points of the subsidy may be used to lower interest rates. Another 11 "are absorbed by higher labor costs."[8] There is little or no effect on deposit rates or other costs.

A host of other studies round out the picture. A 2005 study by the National Community Reinvestment Coalition determined that banks actually do a better job of fulfilling the credit unions' mission than the credit unions. This study highlighted how banks "consistently exceed credit unions' performance in lending to women, minorities, and low and moderate-income borrowers and communities."[9] A 2003 Government Accountability Office study found that credit unions serve a more affluent clientele than banks. This GAO study concluded that "credit unions overall served a lower percentage of households of modest means than banks."[10]

Another study by the Woodstock Institute concluded that credit unions serve a higher percentage of middle- and upper-income customers than lower-income households.[11] Similarly, a study by the Virginia Commonwealth University concluded that credit unions tend to serve a higher proportion of wealthier households in their customer base.[12]

[7] "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," by Professor John A. Tatom, Ph.D. Tax Foundation, 2005.
[8] Page 22.
[9] "Credit Unions: True to Their Mission?" National Community Reinvestment Coalition, May 2005. www.ncrc.org.
[10] General Accounting Office. "Credit Unions: Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management." October 2003.
[11] Woodstock Institute. "Rhetoric and Reality: An Analysis of Mainstream Credit Unions' Record of Serving Low-Income People. February 2002.
[12] School of Business, Virginia Commonwealth University. A Study on the Comparative Growth of Banks and Credit Unions in Virginia: 1985-1995." August 1997.

Today there are more than 120 credit unions with $1 billion or more in assets , providing sophisticated banking products and services to wealthy and middle-income members.

In one instance, the NCUA acted on these facts. Effective November 27, 2000, NCUA adopted a rule that required all credit unions with a community charter to adopt a Community Action Plan. The rule would have required

> that a community credit union address in either its marketing or business plan or other appropriate separate documentation, such as the strategic plan, project differentiation, etc, how it plans on serving the entire community, including how the credit union will market to the community and what products and services will be offered by the credit union to assist underserved members in the community.[13]

Unfortunately, the membership of the NCUA's board changed soon after the agency adopted the CAP requirements and the rule was repealed. In 2002, JoAnn Johnson – then a board member, now chairman – attempted to justify this action by claiming that credit unions were already serving persons of "modest means." This is easier said than proven. During the 2005 Ways and Means Committee hearing on credit unions' tax exemption NCUA Chairman Johnson and credit union representatives had a difficult time demonstrating that they were meeting their statutory mandate of serving persons of modest means.

ICBA believes that the NCUA had the right idea when it adopted the CAP proposal in October of 2000 and took a giant step backward when it repealed the rule the following year. We strongly recommend that Congress build on the agency's work in 2000 and require credit unions to comply with CRA requirements in the same manner, and with the same asset size distinctions, as banks and thrifts.

Conclusion

ICBA greatly appreciates the opportunity to participate in this important hearing. Community bankers are strongly committed to the goals of the Community Reinvestment Act; community investment and development are at the core of each community bank's mission. We appreciate the valuable improvements that the federal financial regulatory agencies have made in CRA examination procedures. They are an excellent example of constructive change that has reduced the burden of regulation while enhancing its effectiveness. ICBA strongly believes that <u>all</u> federally insured depository institutions should comply with CRA under these improved procedures, including the nation's credit unions.

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[13] NATIONAL CREDIT UNION ADMINISTRATION, 12 CFR Part 701, final rule, effective November 27, 2000, section 5, COMMUNITY CHARTERS, COMMUNITY ACTION PLAN (CAP) (since rescinded).